BedfordLending

**HUD 223(f) Repair Rules**

HUD allows projects to fund repairs (as a mortgageable cost) with a 223(f) refinance/acquisition loan. Generally, this process is quite simple. A property condition needs assessment ("PCNA") will be completed by a third party vendor which will identify repair items needed (if any) at the property. The property owner can also elect to complete more repairs than what is identified in the report - repairs exceeding $35,000 must be accompanied by multiple bids.

Once the scope of work has been defined, HUD will escrow monies for the repairs out of loan proceeds, and the work must be completed within a year post-closing. Prevailing wages are not required to be paid under the 223(f) program, unless another component of the project requires prevailing wage inclusion.

Occasionally if the scope of work is substantial enough, a Project Architect and/or General Contractor must be brought in to assist with the repair process. The following details these requirements along with other relevant information surrounding repairs.

**HUD's Defined "Levels of Work"**

1. Level 1 Alterations: "…include the removal and replacement or the covering of existing materials, elements, equipment, or fixtures using new materials, elements, equipment, or fixtures that serve the same purpose." [IEBC Section 503.1].

   *Examples include removing and replacing existing flooring, replacing light fixtures, etc.*

2. Level 2 Alterations: "…include the reconfiguration of space, the addition or elimination of any [exterior] door or window, the reconfiguration or extension of any system, or the installation of any additional equipment." [IEBC Section 504.1]

   *Examples include 1) adding or demolishing interior walls (partition or loadbearing) to reconfigure dwelling unit layout; 2) adding another bathroom inside a unit; 3) relocating the kitchen within a unit; 4) adding a new air conditioning system that was not previously present to the existing buildings and/or units; 5) adding an elevator to the building, etc.*

3. Level 3 Alterations: "…apply where the work area consisting of all reconfigured spaces exceeds 50% of the building area." [IEBC Section 505.1]

**Eligible 223(f) Construction Activities**

Because HUD has a separate program named the 221(d)(4) program specifically for the new construction or "substantial" rehabilitation of buildings, the type of work that can be completed as part of a 223(f) loan must be more limited in nature.

Repairs and Level 1, Level 2 and Level 3 Alterations are permitted, provided that the "Aggregate Cost" of all such repairs and alterations does not exceed approximately ~$45,000 per door. The "Aggregate Cost" includes associated soft costs like Architect / GC fees. The exact dollar amount can be provided on a case-by-case basis.

1. Additions (defined here as any expansion of a building footprint with conditioned space) are not permitted to dwelling spaces and residential buildings. Adding a patio or a balcony is considered a Level 2 Alteration, given that they are not conditioned spaces;

2. Additions to accessory buildings or additions of minor accessory structures (e.g., carports, storage sheds, swimming pools) may be deemed Level 2 or 3 Alterations, subject to the approval of the Director of the Regional Center/Satellite Office;

3. Construction of a new accessory building (e.g., community building, gym) is permitted as a Level 3 Alteration. New accessory buildings may not exceed a gross floor area of 5,000 square feet.

**When Architects are Required**

The Borrower must hire a Project Architect to define work at the property when one of the following conditions is met:

1. The Aggregate Cost (before General Contractor fees or allowances) of all the identified repairs and alterations equals or exceeds $15,000 per unit. Costs exceeding this threshold are evidence that the proposed repairs and alterations are sufficiently complex that the services of a Project Architect are required to ensure the clarity and accuracy of design and specification documents necessary to guide and evaluate all construction.
    a. HUD may waive the requirement to hire a Project Architect when the Aggregate Cost of all repairs and alterations exceeds $15,000 per unit but work is limited to repairs and Level 1 Alterations.

2. When the Aggregate Cost of repairs and alterations is less than $15,000 per unit but the proposed work includes Level 2 or Level 3 Alterations, a Project Architect must be retained to prepare drawings and specifications for the Level 2 or Level 3 Alterations provided as follows:
    a. Work proposed outside the work area where Level 2 or Level 3 Alterations will occur may be excluded from the Project Architect's scope of work.; and
    b. When there are only Level 2 alterations proposed (no Level 3 Alterations), and the Level 2 alterations are nominal (e.g., enlarging a closet in a few units with no accessibility ramifications), the services of a Project Architect are not required.

In the above scenarios, the Project Architect must meet the same licensing and insurance requirements as required under the 221(d)(4) program, including a provision of a Certificate of Professional Liability Insurance. The Owner-Architect agreement must be the AIA Document B104 (a B108 is allowed if the project scope is extensive). The Project Architect's fee must be a fixed sum for the services provided; no other method of stating compensation is acceptable. Separate fee amounts for design and construction services must be stated. These costs/fees are mortgageable, unless the Project Architect has a relationship ("identity of interest)" with the building owners, in which case they are non-mortgageable, and in this scenario a third party Architect must be hired for the supervisory/construction portion of the architectural work (memorialized under a separate AIA B104 form).

**When General Contractors are Required**

The Borrower must hire a General Contractor to conduct all the work defined by the Project Architect and provide coordination as a single point of control for costs, scheduling, and conformance of the work to plans and specifications when one or more of the following conditions are met:

1. The Aggregate Cost of repairs and alterations exceed $15,000 per unit, excluding General Contractor fees;
2. The proposed work includes Level 3 Alterations; or
3. More than three licensed trade contractors are to be employed for the work.

HUD may waive the requirement to hire a General Contractor when:

1. The Aggregate Cost of all repairs and alterations exceeds $15,000 per unit but work is limited primarily to Repairs and Level 1 Alterations; or,
2. The owner has substantial experience and proven ability planning and staging construction tasks, coordinating trades, and supplying general requirements.

The Owner/General Contractor agreement must be in the AIA A104 form. General contractor fees like Builder’s Overhead and Builder’s Profit are mortgageable costs.

**Licensed Trades**

When a General Contractor is not retained, the work items documented by the Architect (e.g., remedies for accessibility deficiencies, limited Level 2 Alterations) must be executed by qualified licensed trades (e.g., a plumber, electrician, framer, tile-setter licensed in the local jurisdiction).

Similarly, repairs and Level 1 Alterations described as individual work items (or a group of closely related items) with an estimated cost of $35,000 or greater must be performed by qualified licensed trades contractor(s).

**Schedule**

When a General Contractor is retained, the General Contractor must submit a detailed construction schedule. All 223(f) loans, regardless of repair scope, require repairs and alterations to be completed within 12 months post-closing.